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CLASSIFIED BY: Jillian Burns, Director, Iran Regional Presence Office - Dubai, Department of State.
REASON: 1.4 (d)

1.(C) Summary. Privatization of state-owned enterprises has been a notional objective of the Iranian government since it implemented its first 5-year economic plan in 1989. Two significant barriers to privatization have been the strict interpretation of Article 44 of the Constitution by the Iranian government, and private sector anxiety about uncertain outcomes of privatization. In July 2006, the Supreme Leader issued a decree redefining Article 44 and thereby opening up most government industries to privatization. Despite the decree, little concrete action to advance privatization efforts followed. In a speech to state officials on February 19, Ayatollah Khamenei criticized the lack of progress on the privatization front and, according to one economist, openly contradicted key aspects of the president's position on privatization. Several contacts predict that IRGC controlled-companies will take over the privatized companies and "real" economic growth will only result from creation of new private enterprises. End Summary.

Privatization efforts 1989-2006

2.(C) Privatization has been an agenda item for the Iranian government since its first post-revolutionary economic development plan in 1989. However, progress has been negligible. An Iranian economist, speaking to IRPoff, attributed the lack of privatization initiatives to two factors. Firstly, a strict interpretation up until 2006 of Article 44 of the Iranian Constitution limited the private sector role in the economy and called for government control of major industries. (Note: Article 44 divides the Iranian economy into three sectors - state, cooperative, and private - and it outlines the size and role of each sector. Endnote) Secondly, there has been no push from the private sector because of overall pessimism that privatization would be conducted in a fair, transparent manner. This pessimism, according to the economist, is compounded by the private sector's inability to help shape government policies.

The Supreme Leader's decree

3.(C) On July 2, 2006, the Supreme Leader issued an executive order which in effect reinterpreted Article 44 of the

Constitution and opened up "most" government sectors to privatization. The economist suggested that the Supreme Leader stepped up privatization efforts to stimulate the creation of sorely needed employment opportunities and to combat criticism that the Islamic Republic is unable to adapt and change. Efforts are allegedly underway to make the Chamber of Commerce more independent in order to directly address the private sector's lack of political representation. The economist also said that political entities affiliated with the business community are on the rise, as well as newspapers devoted to private sector interests, such as Sarmayeh and Etemad. (Comment: To date, IRPoff has seen no evidence of formalized private sector lobbying groups taking root. Much of the private sector's political activity appears to take place informally. End comment).

4.(C) The Supreme Leader's executive order interpreting Article 44 stipulates that up to 80 percent of the shares of "most" government companies are to be privatized, via the Tehran Stock Exchange. By March 2010, the government must withdraw fully from all sectors where the private sector is active, unless it receives permission from the parliament. Private sector participation will be allowed in international trade activities, unless a government monopoly exists. The companies that are up for 80 percent privatization include:
-- all government banks except for the following: the Central Bank, Bank Melli, Bank of Industry and Mines, the Agriculture Bank, Bank Maskan, Bank Sepah and the Export Development Bank (Note. Five known banks appear to be up for privatization: Bank Mellat, Post Bank of Iran, Bank Refah, Bank Saderat Iran and Tejarat Bank. Endnote)
-- all insurance companies except for Iranian Central Insurance
-- all power provision companies except for the main power transfer networks
-- all post and telecommunications companies with the exception of the parent telecommunication network, transfer of frequencies and exchange and distribution of basic mail services.
-- all government aviation and shipping organizations, except for the Civil Aviation Organization and the Ports and Shipping

Organization
-- all downstream oil and gas companies
-- all other government companies, except for companies where the government has a monopoly (such as the Iran Tobacco Corporation) and companies that have regulatory functions (such as Data Services of Iran).

Recent privatization efforts

5.(C) In an address to public officials February 19, Ayatollah Khamenei indicated that necessary steps to privatize much of Iran's economy have not taken place at a satisfactory pace. Khamenei reportedly attributed the delay to a divergence in government opinions but made it clear that all policymaking should be in line with his July 2006 decree. The economist viewed the fact that Khamenei's speech came two days prior to elections for the Iran Chamber of Commerce, Industry and Mines (ICCIM) as an indication that many of "the top leadership is ready for a new era of interaction with the private sector." Reportedly for the first time, reformists claimed the majority of seats in the ICCIM in the February elections. (Note: The ICCIM has 40 private sector representatives and 20 government representatives. Endnote.)

6.(C) The economist noted that the government divergence of opinion referred to by Khamenei is a clash between two distinct groups: 1) those who believe in a 'Chinese style' economic opening which would unleash new economic momentum through private sector investments; and 2) those who want to control all economic activity by passing on economic interests to trusted circles rather than to the real private sector. He claimed Khamenei and Rafsanjani fall into the first camp, but Ahmadinejad and his supporters - who constitutionally control domestic economic policy - fall into the latter group. The

analyst underscored that Ahmadinejad's priority coming into office was redistribution of wealth, not creation of new economic growth. He claimed that Khamenei sent a shot across the bow of the president's camp with his statement February 19 that private sector investors are entitled to suitable profits. This runs contrary to Ahmadinejad's reportedly populous approach. The President, noted one businessman, favors redistribution of 40 percent of private companies to the lower class (known as justice shares) and turning over 40 percent to IRGC cronies.

7.(C) Several business contacts have noted that they "expect" that "privatization" will actually be an opaque process in which state-run companies will be handed over to former IRGC members. The only "real" area for growth, noted one expert, is organic growth of small-to-mid-size entities. Contacts typically note that although setting up a business can be a cumbersome process in Iran, individuals can make a comfortable living as long as their business does not grow "too much." Presumably, because growth beyond a certain level turns businesses into prey for rapacious public officials.

8.(C) Comment. The move toward privatization and a market driven economy could represent a significant change in Iranian economic policy, if properly enacted. However, if as suspected, sectors of the economy that are "privatized" are only transferred from direct government control to the control of government-affiliated entities, little positive economic impact is expected. It's safe to assume that we will see growth in semi-private institutions. Consequently, it is likely that in the short-tem the government's efforts will result in privatization in name but not substance. At this key juncture, if we conclude that privatization of Iran's major industries and services will create a more open, stable, economy and that such a development could help advance US interests, we should explore means of influencing this internal debate in this direction. Public Diplomacy and civil society programming through MEPI and DRL are possible vehicles.
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